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SUBJECT: CENTRAL BANK SEES NO FEDERAL LEVERAGE ON PARANA
GOVERNOR IN OPIC-RELATED INVESTMENT

REF: PLOWMAN-OPIC EMAILS

Sensitive but Unclassified, please protect accordingly.

1. (SBU) Econoff raised with Central Bank Deputy Governor for International Affairs Alexandre Schwartzman on February 19 the difficulties that an OPIC-financed investment fund, the Global Environmental Emerging Markets Fund II (GEEMF) is experiencing with its \$18 million investment in the state of Parana sanitation utility, Sanepar. Econoff explained that the OPIC-financed investment, made through two intermediaries (Opportunity Daleth and the Domino group), formed part of the purchase of a minority stake in Sanepar during its partial privatization. The rights of the private shareholders brought into the company were secured through a shareholders agreement that was subsequently de facto abrogated by state governor Requiiao, who had in addition removed from the Sanepar board the directors named by the private investors.

2. (SBU) Schwartzman was very sympathetic and gave us to understand that the GoB sees Requiiao's actions as indefensible. He went on to say, however, that the Federal Government has limited means of dealing with Requiiao's de facto abrogation of the shareholders agreement. Schwartzman clearly understood the potential for this to become a central-government to central-government issue should OPIC become subrogated to the U.S. private investor. He also perceived the danger of decreased investor confidence for purposes of promoting investment through Public-Private-Partnerships (PPPs), currently under consideration by the Brazilian Congress. Schwartzman recommended that the private investors pursue action through the CVM (SEC-equivalent) and/or local courts, but, when asked, did not know if Brazilian law allows for the central government to file an "amicus" brief supporting the investor's case. He did not think Brazil's Fiscal Responsibility Law provided any federal leverage, because Requiiao's actions diluting the private shareholders' stake in Sanepar do not affect the State of Parana's net debt levels.

3. (SBU) Schwartzman drew a parallel to another infamous case of a few years ago, that of the electrical company of the state of Minas Gerais (CEMIG). Then-governor Itamar Franco removed the board members representing the private investors (which included U.S. company AES) who had bought in during a partial privatization, as Requiiao has now done with Sanepar. Even though the federal government of the time disagreed vehemently with the actions of the state government, it was unable legally to intervene. Despite his pessimism about finding a concrete option to help, Schwartzman undertook to follow up within the Central Bank and with colleagues in the Finance Ministry. Econoff left with him an OPIC white paper on the case.

4. (SBU) In a March 25 follow-up meeting, Schwartzman relayed that he and his Ministry of Finance colleagues had concluded that the federal government has no way to act in the Sanepar case, as the facts currently stand. He said all his colleagues were aware of the potential damage to Brazil's ability to attract investment. When pressed, Schwartzman clarified that he and his colleagues had not considered how the CVM might be brought into play in its regulatory role. He suggested, since the Central Bank has little or no enforcement power outside of its banking supervision role, that post follow up with Finance Ministry Executive Director Bernardo Appy.

5. (SBU) Comment. While post will follow up with the Finance Ministry, the CEMIG precedent is illustrative of the limits that the federal government faces in dealing with governors whose actions, however egregiously a breach of shareholders' agreements, do not apparently represent a violation of federal law in the view of the GoB.

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